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In the Supreme Court of the United States

OCTOBER TERM, 1980

MARINE BANK, PETITIONER

v.

SAMUEL WEAVER AND ALICE WEAVER

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTIONS PRESENTED

1. Whether a certificate of deposit issued by petitioner, a federally regulated bank, is a security subject to the antifraud provisions of the federal securities laws.

2. Whether an agreement requiring respondents to guarantee a bank loan, in return for a percentage of the profits of the borrower and certain other cash and non-cash benefits, is a security subject to the antifraud provisions of the federal securities laws.

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INTEREST OF THE UNITED STATES

This case presents the question whether the antifraud provisions of the federal securities laws apply to a certificate of deposit issued by a federally regulated bank. That question turns on whether such an instrument is a "security" for purposes of those provisions. Although this case calls for an interpretation of the federal securities laws, it is of significance not only to the Securities and Exchange Commission ("SEC"), the agency responsible for administration and enforcement of those laws, but also to the federal bank regulatory agencies—principally the Comptroller of the Currency ("Comptroller"), the Board of Governors of the Federal Reserve System ("Board of Governors"), and the Federal Deposit Insurance Corporation ("FDIC").

The SEC is of the view that the certificate of deposit involved here is not a security in the context of this case. However, the SEC is concerned that the term "security"

not be construed in a way that would call into question the applicability of the securities laws in other contexts. The federal bank regulatory agencies are of the view that certificates of deposit issued by federally regulated banks are not securities under the antifraud provisions of the federal securities laws. Those agencies are concerned that a holding that certificates of deposit are securities would inhibit the ability of banks to attract deposits necessary for the efficient functioning of the nation's banking system, would unduly raise compliance costs, and would interfere with the pervasive scheme of bank regulation prescribed by Congress. The result reached by the court of appeals would, in the view of the federal bank regulatory agencies, have an adverse impact on the daily business of banks engaged in deposit transactions and would result in duplicative and unnecessary regulation.

The SEC and the federal bank regulatory agencies have in the past taken differing positions with respect to the application of the federal securities laws to certain deposit instruments.[1] All of these agencies and the United States believe, however, that the position jointly advocated in this amicus curiae brief—that the certificate of deposit issued by petitioner is not a security in the context of this case—is consistent with congressional intent in enacting the federal securities and banking laws.

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[1] The SEC and the FDIC filed opposing amicus curiae briefs in *Schutte* v. *Bank of Miami*, appeal pending, No. 79-3607 (5th Cir.) (involving certificates of deposit of an off-shore unregulated bank); *Adato* v. *Kagan*, 599 F.2d 1111 (2d Cir. 1979) (involving certificates of deposit of a state-chartered FDIC insured bank); *Safeway Portland Employees' Credit Union* v. *C.H. Wagner & Co.*, 501 F.2d 1120 (9th Cir. 1974) (same). The Comptroller opposed the SEC's position both in the *Safeway* case and in *Burrus, Cootes & Burrus* v. *MacKethan*, 537 F.2d 1262 (4th Cir.), opinion withdrawn and prior judgment aff'd on other grounds, 545 F.2d 1388 (1976), cert. denied, 434 U.S. 826 (1977) (involving certificates of investment issued by an industrial loan corporation).

This case also involves the question whether a loan guarantee agreement is an "investment contract," a term included in the definition of "security" prescribed in the federal securities laws. The SEC and the United States believe that the loan guarantee agreement here at issue is not a security.[2] However, since the traditionally broad interpretation given the term "investment contract" by this Court has proven to be indispensable in policing fraudulent schemes involving non-conventional investment vehicles, the SEC is concerned that the term not be narrowly construed.

STATEMENT

1. Respondents Samuel and Alice Weaver filed suit in the United States District Court for the Western District of Pennsylvania, alleging that they were defrauded by petitioner Marine Bank, a state-chartered commercial bank whose deposits are insured by the FDIC (C.A. App. 4a-12a).[3] Their claims arose from certain transactions involving the Columbus Packing Company, a proprietorship owned by Raymond and Barbara Piccirillo that engages in the wholesale slaughtering and meat packing business. The complaint alleged that the bank induced the Weavers, who are farmers and owners of a cattle auction business, to guarantee a loan to Columbus Packing Company and to secure that guarantee by pledging a $50,000 certificate of deposit (*id.* at 5a). The interest-bearing certificate of deposit, which was issued two months earlier by the bank, had a maturity of six years (Pet. App. A-3). In consideration for their guarantee of the bank loan, the Weavers entered into an agreement with Mr. and Mrs. Piccirillo whereby the Weavers were

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[2] The federal bank regulatory agencies take no position concerning the status under the federal securities laws of the loan guarantee agreement.

[3] "C.A. App." refers to the two volume "appendix for appellants" in the court of appeals.

given the right to use Columbus Packing Company's barn and pastures, to receive 50% of any net profit the company might earn, and to receive $100 per month (C.A. App. 13a-14a).

Mr. Weaver testified during his deposition that he had been asked by Mr. Piccirillo and Marine Bank officials to provide "working capital" to Columbus Packing Company (C.A. App. 303a, 305a-306a). Although Mr. Weaver knew that his agreement with the Piccirillos would give him "a little share" of the business, he never asked for such an interest (*id.* at 318a-319a). Mr. Weaver also testified that he believed he would not lose money on the transaction because (1) Marine Bank's loans to Columbus Packing Company were secured by collateral and (2) Mr. Piccirillo had given him a note for $10,000 secured by Mr. Piccirillo's father's house (*id.* at 310a, 318a). Mrs. Weaver testified that the reason for assisting Mr. Piccirillo was that "he would buy cattle from us, and that would help us" (*id.* at 347a).

The Weavers claimed that both the certificate of deposit that they had pledged to secure the loan and their guarantee agreement with the Piccirillos were "securities" and that they had been induced to enter into these security transactions through misrepresentations by employees of the bank (C.A. App. 104a-105a). They further alleged that Columbus Packing Company had filed a petition in bankruptcy shortly after receiving the loan and that Marine Bank intended to apply the pledged certificate of deposit toward the loan deficiency (*id.* at 8a-9a). They claimed that the misrepresentations by the bank violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, as well as Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a) (C.A. App. 106a, 108a).[4]

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[4] The Weavers' claim concerning the certificate of deposit and the allegations of a violation of Section 17(a) of the Securities

2. The district court granted Marine Bank's motion for summary judgment, concluding that neither the certificate of deposit nor the loan guarantee agreement was a "security" (Pet. App. A-25 to A-29). A divided court of appeals reversed (*id.* at A-1 to A-23). The majority held that a jury could find that the certificate of deposit was the "functional equivalent" of a long term bond or note and thus was a security (*id.* at A-12). The court also held that the loan guarantee agreement could be viewed as either a "certificate of interest or participation in a profit sharing agreement" or an "investment contract," both of which are embraced within the definition of "security" prescribed in Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10) (Pet. App. A-9).

SUMMARY OF ARGUMENT

1. In determining whether the certificate of deposit issued by petitioner is a security subject to the antifraud provisions of the federal securities laws, it is appropriate to begin with the language of the statutes. *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 558 (1979). Although the definition of "security" contained in the federal securities laws is broad and the instrument involved here could be found to fall within its literal language, that definition is qualified by the prefatory clause "unless the context otherwise requires * * *." The legislative history of that clause, and the decisions construing it, establish that courts are not bound by the literal terms of the statutory definition in all cases, and should not treat particular instruments as "securities" if that would extend the federal securities laws to contexts not intended to be regulated by those laws.

Act of 1933 first appeared in a proposed amended complaint (C.A. App. 104a-108a). The district court, although denying leave to amend the complaint, considered the allegations in the proposed amendment as if set forth in the original complaint (Pet. App. A-42).

The context here is a transaction involving a certificate of deposit issued by a federally regulated bank. Federal banking statutes provide comprehensive regulation of all phases of banking operations—regulation carefully designed to assure financial soundness and to protect depositors against failure to repay principal and interest. The protection afforded by this comprehensive scheme of regulation substantially eliminates the need for application of the antifraud provisions of the securities laws. Moreover, as the legislative history indicates, Congress intended that deposit transactions of federally regulated banks would be governed not by the securities laws but by the banking statutes, certain of which were enacted almost simultaneously with the Securities Act of 1933. The conclusion that the certificate of deposit involved here is not a security subject to the antifraud provisions of the federal securities laws harmonizes the federal securities and banking laws, and avoids overlapping jurisdiction that would "serve[] no general purpose." *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 570.

2. This Court need not determine whether the loan guarantee agreement entered into by the Weavers could be characterized "a certificate of interest or participation in any profit sharing agreement" or an "investment contract." Examination of the "context" of this privately negotiated agreement plainly demonstrates that it does not have the economic characteristics of a security and that application of the federal securities laws would depart from Congress' intent.

ARGUMENT

I. THE CERTIFICATE OF DEPOSIT AT ISSUE IN THIS CASE IS NOT A SECURITY SUBJECT TO THE ANTIFRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS

The court of appeals held that a certificate of deposit issued by petitioner, a federally regulated bank, is a

"security" subject to the antifraud provisions of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act. Whether an instrument is a security is a matter of statutory construction. In construing the securities laws, this Court has considered several factors—the statutory language, the legislative history, the statutory scheme, and public policy considerations.[5] In the present case, those factors lead to the conclusion that the certificate of deposit here at issue is not a security subject to the antifraud provisions.

A. The Language of the Statutory Definition Requires Consideration of the Special Regulatory Context of this Case

1. " 'The starting point in every case involving construction of a statute is the language itself.' " *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 558 (1979), quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring). While the term "security" is broadly defined in both Section 2(1) of the Securities Act, 15 U.S.C. 77b(1), and Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10), to include both equity and debt instruments,[6] that definition, like the other definitions, is qualified by the prefatory expression "unless the context otherwise requires * * *." Section 2 of the Securities Act, 15 U.S.C. 77b; Section 3(a) of the Securities Exchange Act, 15 U.S.C. 78c(a). As this Court has

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[5] See, *e.g.*, *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551 (1979); *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976).

[6] Congress chose to define " 'the term security in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.' " *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 847-848 (1975), quoting H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933).

recognized, "[t]he task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes." *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 848 (1975).

The Senate bill and original version of the House bill that later became the Securities Act of 1933 contained the prefatory expression "unless the *text* otherwise indicates." S. 875, 73d Cong., 1st Sess. § 2 (1933); H.R. 4314, 73d Cong., 1st Sess. § 2 (1933) (emphasis added). A later House version of the bill substituted the broader language "unless the *context* otherwise requires." H.R. 5480, 73d Cong., 1st Sess. § 2 (1933) (emphasis added). After passage of the bill by the House and Senate, the House version of the introductory language was adopted in conference and enacted into law. Ch. 38, Section 2, 48 Stat. 74. This same language was included verbatim in each of the securities statutes that later were enacted.[7] The word "context," which Congress deliberately selected, refers to "the surrounding factual circumstances." See, *e.g.*, *Emisco Industries, Inc.* v. *Pro's, Inc.*, 543 F.2d 38, 39 (7th Cir. 1976); accord, *Exchange National Bank* v. *Touche Ross & Co.*, 544 F.2d 1126, 1137-1138 (2d Cir. 1976).[8]

Consistent with Congress' focus on the context of a transaction, this Court's decisions construing the term "security" have held that

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[7] See Section 3(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a); Section 2(a) of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79b(a); Section 303 of the Trust Indenture Act of 1939, 15 U.S.C. 77ccc; Section 2(a) of the Investment Company Act of 1940, 15 U.S.C. (& Supp. III) 80a-2(a); Section 202(a) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-2(a).

[8] The word "context" denotes "the interrelated conditions in which something exists or occurs," "environment," or "surroundings." *Webster's Third New International Dictionary* 492 (1976).

> courts will construe the details of an act in conformity with its dominating general purpose, will read the text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.

SEC v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943).[9] Other decisions of this Court, although not expressly relying on the prefatory language, have utilized this same approach. See, *e.g.*, *Tcherepnin* v. *Knight*, 389 U.S. 332, 336 (1967):

> [I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality.

See also *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 558; *United Housing Foundation, Inc.* v. *Forman*, *supra*, 421 U.S. at 848-849 (noting that "a thing may be within the letter of the statute and yet not within the statute, because not within its spirit nor within the intention of its makers").[10]

The rules of construction that are relevant in this case therefore are sufficiently clear. The starting place is the language of the statute itself. If, however, the context of a given transaction so "requires," a literal application of the statutory definition should be subordinated to

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[9] See also *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 466 (1969).

[10] Although this Court in *Forman* declined to follow a literal approach, the opinion made clear that the name of an instrument is not "wholly irrelevant" to a determination whether the instrument is a security. The Court emphasized that "[t]here may be occasions when the use of a traditional name such as 'stocks' or 'bonds' will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument." The Court added that "most instruments bearing these traditional titles are likely to be covered by the statutes." 421 U.S at 850-851.

Congress' underlying intent. Effectuation of the intention of the legislature remains the touchstone.[11]

2. Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10), defines the term "security" to include any "note" or "debenture." Section 2(1) of the Securities Act, 15 U.S.C. 77b(1), which this Court has construed as being "virtually identical to that contained in the 1934 Act,"[12] defines the term "security" also to include any "evidence of indebtedness." Although the certificate of deposit issued by Marine Bank could be found to fall within this definitional language,[13] the presumption that a security exists may be rebutted by establishing that the "context otherwise requires." *Exchange National Bank* v. *Touche Ross & Co., supra,* 544 F.2d at 1137-1138. In analyzing that issue, it is necessary to go beyond the statutory language and to consider the special regulatory environment in which the instrument was issued. In this connection, it is highly signif-

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[11] We do not suggest that in all cases federal courts need sift the circumstances surrounding a transaction to form an ad hoc opinion on whether the transaction is subject to the federal securities laws. The comprehensive and carefully prescribed definitions in the securities laws ordinarily apply at face value, and generally are themselves a safe guide to congressional intent. See *SEC* v. *C.M. Joiner Leasing Corp., supra,* 320 U.S. at 351; *Tcherepnin* v. *Knight, supra,* 389 U.S. at 339; *United Housing Foundation, Inc.* v. *Forman, supra,* 421 U.S. at 850. As Judge Friendly emphasized in *Exchange National Bank* v. *Touche Ross & Co., supra,* 544 F.2d at 1137-1138, Congress has provided an exception from the literal terms of its definitions when the context so *requires.* The need to look beyond the statutory definitional language arises only in those cases in which there is evidence that transactions of the type at issue were not intended to come within the scope of the statute.

[12] *Tcherepnin* v. *Knight, supra,* 389 U.S. at 336. See also *United Housing Foundation, Inc.* v. *Forman, supra,* 421 U.S. at 847 n.12.

[13] As in the case of notes, debentures, and evidences of indebtedness generally, certificates of deposit represent a transaction in which the use of money is obtained in exchange for a promise to pay interest and to repay a fixed sum at a future date.

icant that the certificate of deposit was issued by a federally regulated bank.

In contrast to the federal securities laws, which through disclosure of material facts enable investors to make an "informed choice" among investments, including an assessment of the risk involved, the regulation of the banking industry, like that of the insurance industry, emphasizes pervasive governmental supervision to substantially eliminate the risk of loss. See *SEC* v. *Variable Annuity Life Insurance Company*, 359 U.S. 65, 77 (1959) (Brennan, J., concurring). Under the federal bank regulatory scheme, almost all phases of the business of national, state member, and insured state non-member banks are regulated at the federal level.[14] The Board of Governors regulates state chartered banks that are members of the Federal Reserve System. 12 U.S.C. 241 *et seq.* The Comptroller is charged with the administration of the national banking system and the regulation of all national banks. See 12 U.S.C. 1 *et seq.* The FDIC insures the deposits of all national banks, all state banks that are members of the Federal Reserve System, and all state non-member banks that have qualified for and obtained federal deposit insurance. In addition, the FDIC supervises, in conjunction with state banking agencies, insured state banks that are not members of the Federal Reserve System. 12 U.S.C. (& Supp. III) 1811 *et seq.*

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[14] As one informed commentator has observed, "[t]he regulation of banking may be more intensive than the regulation of any other industry, and it is the oldest system of economic regulation. The system may be one of the most successful, if not the most successful. The regulation extends to all major steps in the establishment and development of a national bank, including not only entry into the business, changes in status, consolidations, reorganizations, but also the most intensive supervision of operations through regular examination of banks." K. Davis, *Administrative Law Treatise* § 4.04 at 247 (1958). See also *Fahey* v. *Mallonee*, 332 U.S. 245, 250 (1947) ("Banking is one of the longest regulated and most closely supervised of public callings").

Federal standards are set for entry into the banking industry through the authority of the Comptroller to issue charters to national banks and the authority of the FDIC to deny federal deposit insurance to state banks that fail to meet specified criteria.[15] Banks also are subject to reserve,[16] reporting,[17] and inspection[18] requirements, which are designed to assure financial soundness. In addition, banking regulation places limits on advertising by banks with respect to the description of interest

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[15] 12 U.S.C. (& Supp. III) 27 (national banks); 12 U.S.C. 322 (state member banks). The FDIC has considerable authority over the entry of banks into the deposit receiving business. All national and state member banks must be insured; the Comptroller and the Board of Governors certify to the FDIC that a bank meets prescribed standards before insurance will be provided. 12 U.S.C. 1814. Although states are empowered to issue charters, the attractiveness of federal deposit insurance gives the FDIC the ability to influence the grant of charters to state non-member banks. Several of the nation's largest states require that the deposits of banks they charter be insured by the FDIC. See, *e.g.*, N.Y. Banking Law § 32 (McKinney Supp. 1980-1981); Pa. Stat. Ann. tit. 7, § 105(a) (Purdon Supp. 1981-1982); Cal. Administrative Register of the Superintendent of Banks 79, No. 2-B §§ 10.139, 10.3520 (Jan. 13, 1979).

[16] 12 U.S.C. 461(b), as amended by Pub. L. No. 96-221, Section 103, 94 Stat. 133-138; see also Board of Governors, *Reserve Requirements of Depository Institutions: Regulation D* § 204.5 (1980), as amended by 45 Fed. Reg. 56022 (1980) and 46 Fed. Reg. 10140 (1981) (to be codified at 12 C.F.R. 204.3) (national banks, state member banks and state non-member banks).

[17] 12 U.S.C. 161 (national banks); 12 U.S.C. 324 (state member banks); 12 U.S.C. (& Supp. III) 1817 (state non-member insured banks).

[18] 12 U.S.C. 481 (national banks); 12 U.S.C. 483 (member banks); 12 U.S.C. (& Supp. III) 1820(b) (state non-member insured banks). Federal banking agencies fulfill their regulatory responsibilities primarily through on-site examinations of the banks they supervise, with follow-up supervision for correction of any detected deficiencies or violations of law. When instruction are not followed or when further action is deemed necessary for any other reason, the banking agencies may initiate formal administrative cease and desist proceedings and may remove dishonest management. See 12 U.S.C. (& Supp. III) 1818.

paid on deposits,[19] including a broad prohibition of any advertisement by a bank "which is inaccurate or misleading or which misrepresents its deposit contracts." [20]

Banks are exempt from coverage under the Federal Bankruptcy Act and instead are subject to special rules governing bank insolvencies. 11 U.S.C. 22; 11 U.S.C. (Supp. III) 109(b)(2). In the case of national banks, the Comptroller is charged with determining when a bank is insolvent and when it is necessary to appoint a conservator. 12 U.S.C. 191 *et seq.*, 201 *et seq.* If the chartering authority determines to close a bank, the FDIC is required to pay the depositors the amount of their insured deposits. 12 U.S.C. 1821(f). In lieu of this procedure, the FDIC may make loans to, purchase the assets of, or make deposits in a distressed bank or take other measures to minimize potential losses, including arranging a merger of the distressed bank with another insured bank. See 12 U.S.C. 1823(c), (e). By use of this authority, the banking agencies can achieve repayment of virtually all the monies owed to a bank's depositors and other creditors.[21]

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[19] 12 C.F.R. 217.6 (member banks); 12 C.F.R. 329.8 (insured state non-member banks). See *FDIC* v. *Sumner Financial Corporation*, 451 F.2d 898, 900-905 (5th Cir. 1972).

[20] 12 C.F.R. 217.6(g); 12 C.F.R. 329.8(f).

[21] Since the formation of the FDIC in 1933, 568 insured banks have been closed. Of that number 310 have had their insured deposits paid off and 258 have, with the financial assistance of the FDIC, been merged with or sold to other insured banks. In addition, five banks have received direct loans from the FDIC. With respect to the 568 federally insured banks that were closed as of year-end 1980, 99.9% of the depositors actually received or were assured payment of their deposits in full and 99.8% of the total deposits were paid or made available. While recovery of uninsured portions of deposits may vary, an aggregate of nearly 97.3% of uninsured deposits had been paid or made available in the 310 pay-off cases as of year-end 1980. In those same cases, 99.2% of the depositors received payment in full. In the 258 purchase and assumption cases, all depositors were fully protected. All depositors were fully protected in the five cases involving direct assistance from the FDIC. *1980 Annual Report of the FDIC* 18-21 (1981).

The primary purpose for applying the antifraud provisions of the federal securities laws to certificates of deposit would be to protect bank depositors against deception regarding the likelihood of repayment of principal and interest. While crucial for the protection of investors in most situations, the need for this safeguard is minimized when the instruments being purchased by the public are certificates of deposit issued by banks subject to a comprehensive scheme of federal regulation that substantially eliminates the risk of non-payment of principal and interest.

The extensive controls over the business operations of banks are not intended to provide protection against ordinary investment risk for the purchasers of a bank's common stock, whose financial interests depend on the profitability of the bank's operations. However, they do extend effective protection to bank depositors, whose financial interests are limited to repayment of their principal together with a fixed dollar return. As pointed out in the dissenting opinion in the court of appeals (Pet. App. A-21):

> [B]ank borrowing and lending activities are closely regulated by designated governmental agencies. Because of this supervision, the need to protect depositors under the Securities Exchange Act is not as apparent as it is with nonbanking entities.

See also *Ayala* v. *Jamaica Savings Bank*, [1981] Fed. Sec. L. Rep. ¶ 98,041 (CCH) (E.D.N.Y. June 15, 1981).

Finally, and of particular pertinence here (see note 41, *infra*), the federal banking agencies possess express statutory authority to protect bank customers, including depositors, against any "unfair or deceptive acts or practices * * * (including acts or practices which are unfair or deceptive to consumers)" that may be committed by federally regulated banks. 15 U.S.C. (& Supp. III) 57a (f). Each bank regulatory agency is authorized to receive complaints from aggrieved bank customers and "to take appropriate action upon complaints with respect to acts or practices by banks subject to its jurisdiction."

Ibid. See also 41 Fed. Reg. 44361-44362 (1976); 12 C.F.R. 227.2. This authority may be implemented under 12 U.S.C. (& Supp. III) 1818(b), which permits the bank regulatory agencies to rectify any "unsafe or unsound practice," or any violation of "law, rule, or regulation," through a "cease and desist order" that may, by "mandatory" terms or otherwise, require the bank to "take affirmative action to correct the conditions resulting from any such violation or practice." *Ibid.* See also 45 Fed. Reg. 48712 (1980) (discussing remedial powers of bank regulatory agencies in Truth in Lending Act cases).[22]

In view of the presence of comprehensive safeguards for depositors provided by the bank regulatory agencies, the language of the securities laws—which requires attention to context—supports the conclusion that the certificate of deposit issued by petitioner is not a security subject to the antifraud provisions.

B. The Legislative History and Statutory Scheme Show that Congress Did Not Intend the Antifraud Provisions To Apply to Deposit Transactions by Federally Regulated Banks

The conclusion that the antifraud provisions do not apply to deposit transactions is supported by an examination of the relevant legislative history and the statutory scheme. That examination shows that Congress intended that the deposit transactions of banks would be governed by the banking statutes rather than the securities laws.

1. In March 1933, President Roosevelt sent to Congress the bill that later was to become the Securities Act. At that time, he expressed the view that bank

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[22] In addition to their formal enforcement authority, each of the agencies provides an informal mechanism through a division of consumer affairs to resolve disputes between banks and their customers involving alleged deceptive or unfair practices. Complaints are typically resolved informally. In some instances, however, the banks involved are directed or formally ordered to take corrective action.

regulation should be embodied in separate legislation. See 77 Cong. Rec. 937 (1933). Shortly after the President sent his message to Congress, the Senate passed a resolution that authorized the Senate Committee on Banking and Currency to continue its investigation of the practices of companies engaged in "the business of banking" and companies engaged in the securities business. S. Res. 56, 73d Cong., 1st Sess. (1933). As a result of these and earlier investigations, Congress enacted the Securities Act of 1933, 15 U.S.C. 77a *et seq.*, the Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.*, and the Banking Act of 1933 (commonly known as the "Glass-Steagall Act").[23] See S. Rep. No. 1455, 73d Cong., 2d Sess. 1-4 (1934). While the securities acts primarily were concerned with the interests of investors,[24] the Glass-Steagall Act focused on the interests of depositors and provided a comprehensive scheme of regulation over many aspects of the operation and management of banking institutions.[25]

The fact that Congress enacted a separate comprehensive scheme of legislation to govern bank deposits is most significant in determining whether Congress intended that the deposit transactions of banks also would be subject to regulation under the federal securities laws. See *Radzanower* v. *Touche Ross & Co.*, 426 U.S. 148,

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[23] The Glass-Steagall Act included the original Federal Deposit Insurance Act. The provisions of the Glass-Steagall Act, ch. 89, 48 Stat. 162, are codified in various sections of Title 12 of the United States Code. While the Glass-Steagall Act uses the term "securities" in various provisions, the meaning of that term as used in Glass-Steagall is not raised by this case.

[24] See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194-195 (1976).

[25] As this Court recently stated in *Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, No. 79-927 (Feb. 24, 1981), slip op. 14: "It is familiar history that the Glass-Steagall Act was enacted in 1933 to protect bank depositors from any repetition of the widespread bank closings that occurred during the Great Depression."

157 (1976).[26] The situation here is comparable to that in *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 569-570. In *Daniel*, this Court found that the prescription by Congress, 40 years after enactment of the federal securities laws, of a comprehensive scheme of legislation governing employee benefit plans provided evidence that an interest in a non-contributory, compulsory pension plan was not a security. The fact that Congress simultaneously enacted two separate regulatory schemes to correct abuses in the securities and banking industries is *a fortiori* evidence of Congress' intent to regulate the deposit business of banks through the banking statutes, not the federal securities laws. See *Ayala* v. *Jamaica Savings Bank*, [1981] Fed. Sec. L. Rep. ¶ 98,041 (CCH) (E.D.N.Y. June 15, 1981).

2. Moreover, the legislative history of the securities laws affirmatively shows that Congress did not intend that deposit instruments issued by commercial banks would be deemed to be securities. At the House hearings, in response to a question from Representative Mapes relating to the coverage of proposed Section 3(a)(2) of the Securities Act, 15 U.S.C. 77c(a)(2), which exempts bank securities from the registration provisions of the Securities Act, Huston Thompson, one of the draftsmen of the bill under consideration, explained that while the bill would encompass "any kind of a security of a national bank," he did "not suppose a national bank would be putting out anything in addition to its capital stock." [27]

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[26] The Court noted in *Radzanower* that, "[w]hile Congress did examine problems stemming from the relationship of banks and the securities business in the early 1930's, * * * it dealt with those problems in comprehensive legislation dealing only with banks." 426 U.S. at 155 n.11. The Court added: "The passage of that legislation * * * suggest[s], if anything, that Congress was reaffirming its view that national banks should be regulated separately by specific legislation applying only to them." *Id.* at 157.

[27] *Federal Securities Act: Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 31 (1933).

Similarly, there is evidence that, in considering the bill that became the Securities Exchange Act, Congress viewed the economic interests of depositors as being distinct from those of investors. It was the interest of investors that required special protection under the securities laws. During the Senate hearings, Senator Adams, a member of the Banking and Currency Committee, and Albert H. Wiggin, a witness and former banker, emphasized that safety of principal was far less a problem for depositors than investors:

> Senator Adams. I am just wondering if, perhaps, this conclusion might be drawn * * *—that the only man, during this period of financial stress who was fortunate, was the man who had money on deposit in a good bank.
>
> Mr. Wiggin. You are entirely right, Senator. The man who had any investments saw the value of those investments shrink, and shrink, and shrink. The man who kept his cash, and had it in a good bank, had no shrinkage.
>
> * * * * *
>
> Yes. It is hard to compare the depositors in the bank with the others.[28]

Thus, investors and depositors were viewed as standing in fundamentally different positions:

> Senator Adams. I saw in some statistics that I was reading the other day that in the closed banks in this country the depositor has ultimately received nearly 70 percent of his money out of the closed banks, and I gather that the stockholder in an open bank has seen his stock shrink from 600 to 125. In other words, the depositor in the closed bank is in

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[28] *Stock Exchange Practices: Hearings on S. Res. 84 and S. Res. 56 Before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess. 2426-2427 (1934).

a more fortunate position than the stockholder in the open bank, on the average.[29]

3. The relevant legislative history and statutory scheme distinguish this case from *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967). In *Tcherepnin*, this Court held that withdrawable capital shares in a state-chartered savings and loan association, as to which payment of dividends was dependent on the profits of the association, were securities subject to the antifraud provisions of the Securities Exchange Act. As the Court observed, the instrument at issue "fit well within several * * * descriptive terms contained in § 3(a)(10)" of that Act (389 U.S. at 339), and the conclusion that it was a security was "reinforced by the legislative history of federal securities legislation." *Id.* at 340. *Tcherepnin* relied in part on express legislative history indicating that Congress specifically examined the need for application of the antifraud provisions to "capital shares" of savings and loan associations. In contrast, the legislative history affirmatively demonstrates that Congress intended that the deposit transactions of banks would be subject to regulation under the federal banking laws, not the federal securities laws.[30] Moreover, in contrast

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[29] *Id.* at 2426-2427. Congress' view that the interests of investors are fundamentally different from those of depositors is also demonstrated by the fact that, while Congress afforded depositors substantial protection through insurance, no such guarantees were afforded investors. See 77 Cong. Rec. 937 (1933) (President's Message).

[30] Of course, in instances unlike this case in which Congress may merely have failed to recognize or anticipate that a particular instrument would fall within the statutory definition, that failure would have little relevance. "[I]f Congress has made a choice of language which fairly brings a given situation within a statute, it is unimportant that the particular application may not have been contemplated by the legislators." *Barr* v. *United States*, 324 U.S. 83, 90 (1945). See also *SEC* v. *W. J. Howey Co.*, 328 U.S. 293, 299 (1946) (the term "investment contract" "embodies a flexible rather than a static principle, one that is capable of adaptation to meet * * * countless and variable schemes").

to federally regulated banks, the state-chartered savings and loan association involved in *Tcherepnin* was not subject to the safeguards of a comprehensive federal regulatory scheme.[31] Accordingly, this Court correctly ruled that the purposes of the federal securities laws would be served by affording protection to the class of persons who invested their money in the association. See ALI, *Federal Securities Code* § 202(150), Comment 7(b) (last sentence) (1980).

4. The conclusion that the certificate of deposit issued by Marine Bank is not a security results in an interpretation of the term "security" that is consistent with the statutory schemes of the federal securities and banking laws.[32] The foregoing analysis, however, may not neces-

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[31] The savings and loan association had been denied federal insurance of its accounts precisely because of its unsafe financial policies. *Tcherepnin* v. *Knight, supra,* 389 U.S. at 334.

[32] The lower courts generally have held that certificates of deposit issued by federally regulated banks are not securities. *Ayala* v. *Jamaican Savings Bank,* [1981] Fed. Sec. L. Rep. ¶ 98,041 (CCH) (E.D.N.Y. June 15, 1981) (Securities Act and Securities Exchange Act); *Drovers Bank* v. *SFC Corporation,* 452 F. Supp. 580, 582 (N.D. Ill. 1978) (Investment Company Act of 1940); see *Bellah* v. *First National Bank,* 495 F.2d 1109, 1116 (5th Cir. 1974) (Securities Exchange Act); *SEC* v. *Fifth Avenue Coach Lines, Inc.,* 289 F. Supp. 3, 31-33 (S.D.N.Y. 1968), aff'd, 435 F.2d 510 (2d Cir. 1970) (Investment Company Act). But see *Young* v. *Seaboard Corp.,* 360 F. Supp. 490, 495-496 (D. Utah 1973) (Securities Exchange Act). See generally *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 300 F. Supp. 1083, 1100 (S.D.N.Y. 1969) (dictum) (Securities Act and Securities Exchange Act), aff'd, 430 F.2d 355 (2d Cir. 1970), rev'd on other grounds, 404 U.S. 6 (1971).

With respect to certificates of deposit or similar instruments issued by institutions that are not federally regulated, the lower courts are divided. Compare *SEC* v. *First American Bank and Trust Company,* 481 F.2d 673, 677 (8th Cir. 1973) (certificates of investment and savings accounts of state banking institution are securities under Securities Act); *MacKethan* v. *Peat, Marwick, Mitchell & Co.,* 439 F. Supp. 1090, 1093-1094 (E.D. Va. 1977) (certificates of investment of state industrial loan association may

sarily apply in other contexts. The better reasoned decisions of the lower courts do not view the question whether a certificate of deposit is a security in the abstract, or in light of the labels attached to a given instrument, but instead turn to a careful consideration of the context. For example, in *Canadian Imperial Bank of Commerce Trust Company* v. *Fingland*, 615 F.2d 465, 470 (7th Cir. 1980), the court explained (emphasis in original):

> We have been cautious not to say that *any* document called a certificate of deposit cannot be a security. The definitional provision begins with the words 'unless the context otherwise requires' and if a victim can adequately plead in non-conclusory allegations showing the context, substance and reality surrounding the sale or purchase of a particular investment, he may well succeed.[33]

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be securities under Securities Act and Securities Exchange Act); *Garner* v. *Pearson*, 374 F. Supp. 591, 596 (M.D. Fla. 1974) (certificates of deposit of Bahamian bank are securities under Securities Exchange Act) with *Canadian Imperial Bank of Commerce Trust Company* v. *Fingland*, 615 F.2d 465, 470 (7th Cir. 1980) (complaint insufficient to establish that certificates of deposit of Bahamian bank are securities under Securities Exchange Act); *Hendrickson* v. *Buchbinder*, 465 F. Supp. 1250, 1254 (S.D. Fla. 1979) (passbooks/certificates of deposit of Bahamian banking entities are not securities under Securities Exchange Act); *Hamblett* v. *Board of Savings and Loan Associations*, 472 F. Supp. 158, 166 (N.D. Miss. 1979) (certificates of deposit, savings certificates and passbooks of state savings and loan are not securities under Securities Act and Securities Exchange Act). See generally *Burrus, Cootes and Burrus* v. *MacKethan*, 537 F.2d 1262, 1265 (4th Cir.) (certificates of investment of state industrial loan corporation are not securities under Securities Exchange Act), opinion withdrawn and prior judgment aff'd on other grounds, 545 F.2d 1388 (1976), cert. denied, 434 U.S. 826 (1977).

[33] Similarly, the Fifth Circuit has recognized that "it may be true that in certain situations a certificate of deposit can be a security as that term is used in the [Securities Exchange] Act * * *." *Reid* v. *Hughes*, 578 F.2d 634, 638 (1978). See also *Bellah* v. *First National Bank, supra*, 495 F.2d at 1109, 1114 & n.6; *Adato* v. *Kagan*, 599 F.2d 1111, 1116 n.5 (2d Cir. 1979).

One context in which a different result might be appropriate is the issuance of certificates of deposit by bank-type entities that are not regulated. The SEC believes that, in such situations, bank-type institutions should not be treated differently than other business corporations that seek capital to conduct business operations through the sale of interest bearing debt obligations.[34]

The Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, also presents a significantly different context. As of May 1981, money market funds registered with the SEC under the Investment Company Act held assets in excess of $118 billion, with approximately 22.9% of those assets invested in domestic certificates of deposit.[35] Money market funds fall within the definition of "investment company" prescribed in Section 3(a)(1) of the Investment Company Act, 15 U.S.C. 80a-3(a)(1), and therefore are subject to regulation under that Act if they are "engage[d] primarily, in the business of investing, reinvesting, or trading in securities."[36] While the lan-

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[34] The SEC has brought enforcement actions against financial institutions that publicly issue debt instruments similar to certificates of deposit, but that are not subject to the comprehensive regulatory scheme provided by federal banking legislation. See, *e.g.*, *SEC* v. *Meek*, Civ. No. 81-227-T) (W.D. Okla.) Lit. Release No. 9391 (July 9, 1981), 23 S.E.C. Docket 75 (state trust company issuing uninsured certificates of deposit and passbook savings accounts); *SEC* v. *Liberty Loan Corporation*, Civ. No. 76-304c (E.D. Mo.) Lit. Release No. 7356 (Apr. 13, 1976), 9 S.E.C. Docket 446 (Morris Plan companies issuing "thrift certificates"); *SEC* v. *Town Enterprises, Inc.*, Civ. No. 75-85 (D. Del.), Lit. Rel. No. 6850 (Apr. 23, 1975), 6 S.E.C. Docket 740 (Morris Plan companies issuing "term investment certificates"); *SEC* v. *First American Bank & Trust Company*, 481 F.2d 673 (8th Cir. 1973) state banking institution issuing "certificates of investment").

[35] See *Donoghue's Money Fund Report* (May 4, 1981).

[36] Money market funds may also be considered investment companies under Section 3(a)(3) of the Act, 15 U.S.C. 80a-3(a)(3).

guage in the Investment Company Act's definition of the term "security" is identical to that in the Securities Act,[37] the regulatory context under the Investment Company Act differs fundamentally from that under the Securities Act and the Securities Exchange Act. The Investment Company Act broadly regulates the operation and management of investment companies.[38] Because the relationship between a money market fund and its shareholders is identical to the relationship between any other investment company and its shareholders, and because the assets of both investment media are highly liquid and are subject to external management, investor protection requires that money market funds continue to be regulated under the Investment Company Act. Since the bank regulatory statutes generally do not apply to the operation of these funds, and since the exclusion of cer-

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[37] See Section 2(a)(36) of the Investment Company Act, 15 U.S.C. 80a-2(a)(35).

[38] That Act prescribes important provisions regulating the valuation of assets (15 U.S.C. 80a-2(a)(41)(B), 17 C.F.R. 270.2a-4), the presence of disinterested directors (15 U.S.C. 80a-10(a)), the performance of fiduciary duty (15 U.S.C. 80a-35), the compensation of the funds' investment advisers (15 U.S.C. 80a-15(a)), the safekeeping of assets and bonding (15 U.S.C. 80a-17(f)), and company transactions with affiliates (15 U.S.C. 80a-17(a), 80a-17(d), and 80a-17(e)). See generally, *Report of the Staff of the Division of Investment Management of the Securities and Exchange Commission on the Regulation of Money Market Funds Before the Senate Comm. on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. (1981).

The SEC recently settled three administrative proceedings involving money market funds and affiliated persons and has commenced proceedings against others. See *Government Securities Management Co. and Fundlink Information Services*, Investment Company Act Release No. 11583, 21 S.E.C. Docket 1495 (Jan. 26, 1981); *Reserve Management Corporation*, Investment Company Act Release No. 11394, 21 S.E.C. Docket 190 (Oct. 10, 1980); *Paul Buchbaum & S. Jay Levy*, Investment Company Act Release No. 11065, 19 S.E.C. Docket 805 (Mar. 4, 1980); *First Multifund Advisory Corp.*, Investment Company Act Release No. 11064, 19 S.E.C. Docket 804 (Mar. 4, 1980).

tificates of deposit from the definition of security in the Investment Company Act would seriously undermine the protections contemplated by Congress, the SEC believes that the relevant context requires that the term "security" take on a "different coloration" under the Investment Company Act. See *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 466 (1969) (holding that "[t]he meaning of particular phrases must be determined in context," and that the term "sale" has a "different coloration" under the registration provisions of the Securities Act than under the antifraud provisions of the Securities Exchange Act because the "context otherwise requires").[39]

To avoid foreclosing the foregoing issues,[40] we respectfully urge the Court to limit its focus to the applicability of the antifraud provisions of the Securities Act and the Securities Exchange Act to the facts of this case. The Court should make it clear that its decision does not resolve the question whether the federal securities laws are applicable in other contexts involving certificates of deposit.

C. Redundant Regulation that Provides No Substantial Public Benefit Should Be Avoided

Application of the antifraud provisions to certificates of deposit issued by federally regulated banks would mean that an industry that already is subject to pervasive regulation to protect depositors would be subject to

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[39] See also *Steadman* v. *SEC*, No. 79-1266 (Feb. 25, 1981), slip op. 8 (holding that "in view of the entirely different purposes of § 7(c) and § 10(e) [of the Administrative Procedure Act] * * *" the words "substantial evidence" appearing in both sections are given "different meanings in context"). Although the American Law Institute's *Federal Securities Code* would exclude from the definition of security a certificate of deposit issued by a regulated bank, that exclusion would not apply under the provisions of the Code governing investment companies. See ALI, *Federal Securities Code* § 202(150)(B)(v) (1980).

[40] Another situation that may present a different context is the trading of certificates of deposit in the secondary market, a circumstance that is not presented in this case.

regulation under another federal scheme. The antifraud provisions would bring into play the investigative and enforcement authority of the SEC, including its authority to subpoena records, take testimony, and commence enforcement actions seeking disclosure and other injunctive relief. See Sections 19(b) and 20(b) of the Securities Act, 15 U.S.C. 77s(b) and 77t(b); Section 21 of the Securities Exchange Act of 1934, 15 U.S.C. 78u; *Aaron* v. *SEC*, 446 U.S. 680 (1980).

The two schemes of regulation—banking regulation and securities regulation—have different orientations. The federal bank regulatory agencies have effectively protected depositors while maintaining necessary confidentiality of bank operations. Indeed, in certain cases, such confidentiality may be essential to maintain the financial integrity of banks and to preserve public trust in the banking system. Application of the antifraud provisions, with their emphasis on disclosure, could, in the view of the bank regulatory agencies, interfere with the federal scheme of bank regulation prescribed by Congress and impose unwarranted costs on banks and their customers.

As this Court recognized in *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 569-570, sound principles of statutory construction require the avoidance of unnecessary and potentially inconsistent overlap in the regulatory jurisdiction of federal agencies. In reaching the conclusion in *Daniel* that an employee's interest in a noncontributory, compulsory pension plan is not a security, this Court noted that the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. 1001 *et seq.*, unlike the federal securities laws, "deals expressly and in detail with pension plans." 439 U.S. at 569. In particular, the Court recognized that ERISA requires pension plans to disclose specified information and regulates the substantive terms of pension plans. *Id.* at 569-570. Similarly, the certificate of deposit at issue in this case was issued by a bank subject to comprehensive regu-

lation to assure honesty in its dealing in such certificates and the continuing financial stability of the issuer. In light of those protections, application of the antifraud provisions "serves no general purpose" (*id.* at 570) and would defeat Congress' intent to remove from the scope of the securities laws those "types of securities and securities transactions where there is no practical need for [the statutes'] application or where the public benefits are too remote." H.R. Rep. No. 85, 73d Cong., 1st Sess. 5 (1933). See *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 477 (1977); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 41 (1977).[41]

II. THE LOAN GUARANTEE AGREEMENT INVOLVED IN THIS CASE IS NOT A SECURITY WITHIN THE MEANING OF THE FEDERAL SECURITIES LAWS

The court of appeals also held (Pet. App. A-5 to A-9) that the loan guarantee agreement between the Weavers and the Piccirillos could constitute a "certificate of interest or participation in any profit-sharing agreement" or an "investment contract." This Court need not, however, decide whether the agreement can be so classified. Regardless of the literal applicability of the statutory terms relied on by the court of appeals, the "context" of this case "requires" that the agreement not be treated as a security.

This Court's decisions establish that, while "most instruments bearing these traditional titles [the titles included within the statutory definitions of security] are likely to be covered by the statutes" (*United Housing Foundation, Inc.* v. *Forman, supra*, 421 U.S. at 850), unusual cases may arise in which inflexible application

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[41] Cases of alleged bank fraud that do not involve securities, such as the present case, are properly cognizable in state court (see generally *Santa Fe Industries, Inc.* v. *Green, supra*, 430 U.S. at 478) or before the banking agencies under statutory provisions such as 15 U.S.C. (& Supp. III) 57a(f) (see pages 14-15, *supra*).

of the statutory definition would be contrary to Congress' intent. This is particularly true when instruments are created in primarily consumer or mercantile contexts, not involving a public distribution. Thus, this Court has stated that "'[t]he test . . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.'" *SEC* v. *United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967), quoting *SEC* v. *C. M. Joiner Leasing Corp.*, *supra*, 320 U.S. at 352-353.

For example, in *Forman* this Court concluded that shares of stock issued by a housing cooperative were not securities even though the statutory definition literally encompassed all species of "stock." The Court noted that the plaintiffs were induced to purchase the stock "solely to acquire subsidized low-cost living space" and not to "invest for profit" (421 U.S. at 851). The lower courts have faced comparable complexities in construing the term "note" appearing in the statutory definitions of "security." Many notes are investment vehicles properly subject to the antifraud provisions of the federal securities laws. On the other hand, the lower courts repeatedly have refused to apply the term "note" in a literal manner to encompass promissory notes issued by individuals to banks, notes given in consumer installment transactions, or short term commercial notes secured by accounts receivable. Although the courts have not arrived at a consensus in specifying the governing criteria,[42] they are

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[42] For example, the Fifth, Seventh and Tenth Circuits rely on a dichotomy between "investment" and "commercial" transactions. See, *e.g.*, *Williamson* v. *Tucker*, 645 F.2d 404, 426-429 (5th Cir. 1981); *Bellah* v. *First National Bank*, *supra*, 495 F.2d at 1111-1114; *Zabriskie* v. *Lewis*, 507 F.2d 546, 550-552 (10th Cir. 1974); *Emisco Industries, Inc.* v. *Pro's, Inc.*, *supra*, 543 F.2d at 39-41. The Ninth Circuit examines a transaction's context to determine whether it is properly viewed as a "risk capital" transaction. See, *e.g.*, *Amfac Mortgage Corp.* v. *Arizona Mall of Tempe, Inc.*, 583 F.2d 426, 431-432 (1978). The Second Circuit, in contrast,

united in their willingness to examine the "context" of a transaction that, although falling within the literal terms of the statutory definition, does not appear to come within the intent of the drafters.[43] This inquiry has been motivated by the concern expressed by the Fifth Circuit in *Bellah* v. *First National Bank*, 495 F.2d 1109, 1114 (5th Cir. 1974): "We doubt that Congress intended by these Acts to render federal judges the guardians of all beguiled makers or payees."

Among the factors that courts have considered in determining whether a particular note could reasonably be viewed as an investment subject to the protections Congress afforded under the federal securities laws are: (1) the number of instruments issued and the number and nature of the payees; (2) the existence of underwriting or promotional activity; (3) the manner in which the instruments are characterized in the business community; (4) the manner in which the proceeds are used; and (5) the length of time to maturity. See, *e.g.*, *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1361-1362 (7th Cir.), cert. denied, 423 U.S. 825 (1975); *McClure* v. *First National Bank*, 497 F.2d 490, 493-494

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begins with a presumption that the statute encompasses any note, but recognizes exceptions for note transactions bearing a "family resemblance" to consumer and mercantile transactions. See *Exchange National Bank* v. *Touche Ross & Co.*, *supra*, 544 F.2d at 1137-1138. The authorities are discussed in Sonnenschein, *Federal Securities Laws Coverage of Note Transactions: The Antifraud Provisions*, 35 Bus. Law. 1567 (1980). The American Law Institute's *Federal Securities Code* § 202(150)(B)(iii) and Comment 6 (1980) excludes from the definition of security "a note or evidence of indebtedness issued in a primarily mercantile or consumer, rather than investment, transaction not involving a distribution." The Comment describes this formulation as a codification of the emerging principle and as "the least imperfect solution to a troublesome problem."

[43] See *United Housing Foundation, Inc.* v. *Forman*, *supra*, 421 U.S. at 849 n.14 (referring with approval to lower court decisions declining to follow a literal approach in applying the term "note").

(5th Cir. 1974), cert. denied, 420 U.S. 930 (1975).[44] While we do not endorse all of the discussion appearing in the lower court decisions,[45] we agree that their focus on "context" in doubtful cases is consistent with the "economic realities" criterion announced in this Court's opinions.[46]

On its face, the Weavers' loan guarantee agreement has few characteristics ordinarily associated with a security. And examination of the "context" confirms that view. The economic substance of the agreement was that the Weavers assisted their neighbors in obtaining a loan from a commercial bank.[47] They received in return a combination of cash and non-cash benefits uniquely suited to their business needs. The loan in question was a demand loan (Pet. App. A-3). The proceeds of the loan were used not for the acquisition of capital assets but for payment of past due bank loans, taxes, and debts owing to trade creditors, as well as for general "working capital" (*ibid.*). Unlike the ordinary security holder who receives dividends or interest, the Weavers obtained use of the Piccirillos' barn and pasture, subject to the Piccirillos' discretion (*id.* at A-15). While the Weavers were entitled to receive certain cash payments and a portion of any profits of the business, those benefits were to last

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[44] Of course, the securities laws do "not stop with the obvious and commonplace." In appropriate cases, "[n]ovel, uncommon, or irregular devices" may be reached under the antifraud rules. *SEC* v. *C. M. Joiner Leasing Corp.*, *supra*, 320 U.S. at 351. "And the fact that the transaction is not conducted through a securities exchange or an organized over-the-counter market is irrelevant to the coverage of § 10(b)." *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 10 (1971).

[45] We are mindful of this Court's warning in *SEC* v. *National Securities, Inc.*, *supra*, 393 U.S. at 465, that questions such as these "arise in an area where glib generalizations and unthinking abstractions are major occupational hazards."

[46] See, *e.g.*, *International Brotherhood of Teamsters* v. *Daniel*, *supra*, 439 U.S. at 558; *Tcherepnin* v. *Knight*, *supra*, 389 U.S. at 336; *SEC* v. *W. J. Howey Co.*, *supra*, 328 U.S. at 298.

[47] See C.A. App. 159a, 161a-164a, 167a-168a, 225a-226a, 238a-240a, 266a-267a, 302a-306a, 310a, 317a-319a, 341a-342a, 347a.

only so long as the demand note from the bank was outstanding.

The Weavers conceded in their depositions that they were not seeking an investment, but rather intended only to help their neighbors raise working capital to meet short-term business needs (see page 4, *supra*). Mrs. Weaver also testified that the reason for agreeing to the transaction was to encourage the Piccirillos to buy cattle from their auction business (*ibid.*). Accordingly, whether or not the loan guarantee agreement fits within one of the statutory terms, an examination of the context shows that this individually negotiated loan guarantee transaction is not the type of transaction the securities laws were intended to reach.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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